

Michigan State Housing Development Authority

*Financial Statements and Required Supplementary
Information for the Years Ended June 30, 2003 and
2002, Supplemental Data for the Year Ended
June 30, 2003, Independent Auditors' Report, and
Independent Auditors' Report on Compliance and on
Internal Control Over Financial Reporting Based Upon
the Audit of the Financial Statements for the Years
Ended June 30, 2003 and 2002*

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

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INDEPENDENT AUDITORS' REPORT

To the Members of the Board of Directors of the
Michigan State Housing Development Authority and Auditor General:

We have audited the accompanying balance sheets of the Michigan State Housing Development Authority (the "Authority") (a component unit of the State of Michigan) as of June 30, 2003 and 2002 and the statements of revenue and expenses and changes in fund equity and of cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the balance sheets of the Michigan State Housing Development Authority as of June 30, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying required supplementary information, Management's Discussion and Analysis of Financial Position and Results of Operations, on pages 2 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Authority taken as a whole. The supplemental data, Balance Sheet Information and Statement of Revenue and Expenses and Changes in Fund Equity Information contained on pages 26 through 29, is presented for the purpose of additional analysis of the financial statements rather than to present the financial position, and results of operations of the individual activities, and is not a required part of the 2003 financial statements. This supplemental data is also the responsibility of the Authority's management. Such supplemental data has been subjected to the auditing procedures applied in our audit of the 2003 financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the 2003 financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 10, 2003 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

October 10, 2003

Management's Discussion and Analysis of Financial Position and Results of Operations (Unaudited)

Michigan State Housing Development Authority (the "Authority") provides financial and technical assistance through public and private partnerships to create and preserve decent, affordable housing for low and moderate-income Michigan residents. The Authority was created under the terms of Act 346, Public Acts of Michigan, 1966, as amended. The Authority is authorized to issue its bonds and notes to the investing public in order to create a flow of private capital through the Authority into mortgage loans to qualified housing sponsors and to certain qualified individuals.

The Authority offers a variety of programs to provide affordable housing opportunities, such as single-family lending, low-interest property improvement lending, multi-family lending, mortgage credit certificates, and pass-through obligations.

The enclosed financial statements present the Authority's financial position, revenue and expenses and changes in fund equity, and cash flows. The following is a condensed summary of financial information as of and for the years ended June 30, 2003 and 2002, respectively.

Condensed Financial Information

(In Thousands of Dollars)

	2003	2002
Balance Sheet		
Investments	\$ 684,740	\$ 618,262
Loans Receivable, Net	1,802,545	1,930,718
Total Assets	2,691,552	2,749,399
Bonds Payable	1,713,065	1,828,839
Total Liabilities	2,204,341	2,314,073
Restricted Fund Equity	242,277	201,747
Unrestricted Fund Equity	244,934	233,579
Total Fund Equity	487,211	435,326
	2003	2002
Operating Results		
Fair Value Adjustment of Investments	\$ (2,638)	\$ 1,351
Net Investment Income	76,545	60,911
Federal Assistance Programs Revenue	221,126	191,723
Section 8 Program Administrative Fees	9,928	9,111
Contract Administration Fees	7,219	6,286
Other Income	22,922	4,159
Total Revenue	337,740	272,190
Federal Assistance Programs Expenses	221,126	191,723
Salaries and Benefits	16,028	19,733
Other General Operating Expenses	17,667	16,977
Total Expenses	268,468	232,401
Grants and Subsidies	17,387	12,130
Change in Fund Equity	51,885	27,659
Ending Fund Equity	487,211	435,326

Financial Position

Total assets decreased from \$2.75 billion at June 30, 2002 to \$2.69 billion at June 30, 2003. This was a decrease of \$57.8 million, or 2.1 percent. This decrease was primarily comprised of a decrease in single-family mortgage loans of \$112.2 million, which was partially offset by an increase in investments of \$66.5 million.

Net loans receivable decreased from \$1,930.7 million at June 30, 2002 to \$1,802.5 million at June 30, 2003. Loans receivable decreased due to the acceleration of single-family mortgage loan prepayments, caused by a low interest rate environment. The allowance for loan losses increased from \$33.0 million at June 30, 2002 to \$43.0 million at June 30, 2003. This increase is attributable to three developments that have realized structural problems that may lead to serious financial distress. The allowance represents 2.38 percent and 1.71 percent of loans receivable at June 30, 2003 and 2002, respectively.

Bonds payable decreased from \$1,828.8 million at June 30, 2002 to \$1,713.1 million at June 30, 2003, a net decrease of \$115.8 million. This decrease was primarily due to the Authority issuing \$324.3 million of Rental Housing Revenue Bonds and \$92.4 million of Single-Family Mortgage Revenue Bonds during the fiscal year, while bond calls and scheduled debt service totaled \$527.2 million.

Escrow funds increased by \$22.6 million to \$380.5 million at June 30, 2003 from a year earlier primarily due to the increased unrealized gain in the fair market value of investments. As interest rates declined during the year, the value of the higher interest rate bonds held in the escrow account increased, resulting in unrealized gains.

The Authority's Fund Equity totaled \$487.2 million at June 30, 2003, equal to 18.1 percent of total assets and 22.1 percent of total liabilities. A significant portion of Fund Equity is restricted. At June 30, 2003, \$242.3 million of Fund Equity was pledged for payment against the various bond indentures. In addition, \$55.2 million is restricted by board resolution, represented by the Community Development Fund.

Results of Operations for the Year Ended June 30, 2003 Compared to the Year Ended June 30, 2002

Operations for the year ended June 30, 2003 resulted in excess of revenues over expenses of \$51.9 million, an increase of \$24.2 million compared to prior year results of \$27.7 million. Under Governmental Accounting Standards Board ("GASB") Statement No. 31, the Authority is required to present investments at fair market value and reflect this adjustment in the Statements of Revenue and Expenses and Changes in Fund Equity. This presentation decreased revenue over expenses by \$2.6 million. Results for the year ended June 30, 2002 were positively impacted by an increase of \$1.4 million. Currently, GASB No. 31 has had a cumulative positive effect of \$7.8 million on the Authority's Fund Balance, however, the Authority generally intends to hold these securities to maturity.

Net investment income increased from \$60.9 million in 2002 to \$76.5 million in 2003, an increase of \$15.6 million. On October 1, 2002, the 1992 Series A Rental Housing Revenue Bonds were called from the proceeds of the Rental Housing Revenue Bonds, 2002 Series B and C. On June 2, 2003, the 1993 Series A Rental Housing Revenue Bonds were called from the proceeds of the Rental Housing Revenue Bonds, 2003 Series A. As a result of the termination of the 1992 and 1993 Series, \$23.1 million of deferred interest income on the underlying mortgage loans, previously held by such Bond Series, was recognized into mortgage loan interest income. This positive variance in net interest income was partially offset by an unfavorable variance in net interest margin. Net interest margin was lower than the prior year due to lower interest rates on mortgage loans and investments, which was partially offset by lower interest rates on bonds payable. Interest rates on mortgages are lower than the prior year due to the high level of prepayments on single-family and multi-family mortgage loans.

Total revenue increased from \$272.2 million for the year ended June 30, 2002 to \$337.7 million for the year ended June 30, 2003, a net increase of \$65.5 million. Total revenue increased due primarily to the recognition of \$23.1 million in deferred mortgage interest income noted above and an increase of \$15.2 million in preservation fees, which are included in other income. Federal Assistance revenues increased by \$29.4 million from the prior year. This increase is primarily from the additional Section 8 contracts administered for the Department of Housing and Urban Development.

Total expenses increased from \$232.4 million for the year ended June 30, 2002 to \$268.5 million for the year ended June 30, 2003, a net increase of \$36.1 million. Total expenses increased due primarily to an increase in the costs incurred for administration of the Section 8 contracts mentioned above. The Authority increased the provision for possible losses on loans by \$10.6 million as compared to an increase of \$1.1 million in 2002. The increase in the provision for possible losses is due to certain developments that have realized structural problems that may lead to serious financial distress. If these developments fail, it will not have a material affect on the Authority's financial strength.

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

BALANCE SHEETS

JUNE 30, 2003 AND 2002

(In Thousands of Dollars)

ASSETS	2003	2002
CASH AND CASH EQUIVALENTS	\$ 144,206	\$ 151,586
INVESTMENTS, including related interest receivable of \$3,812 and \$4,022, respectively	684,740	618,262
LOANS RECEIVABLE:		
Multi-family mortgage loans	1,276,755	1,280,829
Single-family mortgage loans	550,611	662,826
Home improvement and moderate rehabilitation loans	<u>13,502</u>	<u>16,399</u>
Subtotal	1,840,868	1,960,054
Add interest receivable	16,001	14,508
Less allowance for possible losses	(43,000)	(33,000)
Less mortgage discount	<u>(11,324)</u>	<u>(10,844)</u>
Loans receivable—net	1,802,545	1,930,718
OTHER ASSETS:		
Unamortized bond financing costs	4,332	4,443
Real estate owned	10,819	9,500
Other	<u>44,910</u>	<u>34,890</u>
Total other assets	<u>60,061</u>	<u>48,833</u>
TOTAL	<u>\$2,691,552</u>	<u>\$2,749,399</u>
LIABILITIES AND FUND EQUITY		
LIABILITIES:		
Bonds payable	\$1,713,065	\$1,828,839
Accrued interest payable	9,264	14,543
Escrow funds	380,528	357,896
Deferred mortgage interest income	47,980	62,100
Other	<u>53,504</u>	<u>50,695</u>
Total liabilities	2,204,341	2,314,073
COMMITMENTS AND CONTINGENCIES (Notes 3, 6, 8, 12 and 13)		
FUND EQUITY:		
Restricted	242,277	201,747
Unrestricted	<u>244,934</u>	<u>233,579</u>
Total fund equity	<u>487,211</u>	<u>435,326</u>
TOTAL	<u>\$2,691,552</u>	<u>\$2,749,399</u>

See notes to financial statements.

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

STATEMENTS OF REVENUE AND EXPENSES AND CHANGES IN FUND EQUITY

YEARS ENDED JUNE 30, 2003 AND 2002

(In Thousands of Dollars)

	2003	2002
OPERATING REVENUES:		
Investment income:		
Loan interest income	\$ 150,368	\$ 139,750
Investment interest income	16,180	26,528
Net increase in fair value of investments, including change in unrealized (losses) gains of \$(2,638) and \$1,351, respectively	<u>3,130</u>	<u>3,072</u>
Subtotal	169,678	169,350
Less interest expense and debt financing costs	<u>93,133</u>	<u>108,439</u>
Net investment income	76,545	60,911
Other revenue:		
Federal assistance programs	221,126	191,723
Section 8 Program administrative fees	9,928	9,111
Contract administration fees	7,219	6,286
Other income	<u>22,922</u>	<u>4,159</u>
Total other revenue	<u>261,195</u>	<u>211,279</u>
Total operating revenues	337,740	272,190
OPERATING EXPENSES:		
Federal assistance programs	221,126	191,723
Salaries and benefits	16,028	19,733
Other general operating expenses	17,667	16,977
Loan servicing and insurance costs	3,495	2,873
Provision for possible losses on loans	<u>10,152</u>	<u>1,095</u>
Total operating expenses	<u>268,468</u>	<u>232,401</u>
OPERATING INCOME BEFORE GRANTS AND SUBSIDIES	69,272	39,789
GRANTS AND SUBSIDIES	<u>(17,387)</u>	<u>(12,130)</u>
NET INCOME	51,885	27,659
FUND EQUITY—BEGINNING OF YEAR	<u>435,326</u>	<u>407,667</u>
FUND EQUITY—END OF YEAR	<u>\$ 487,211</u>	<u>\$ 435,326</u>

See notes to financial statements.

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2003 AND 2002

(In Thousands of Dollars)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loan receipts	\$ 449,191	\$ 330,763
Other receipts	436,595	369,195
Loan disbursements	(190,181)	(205,265)
Payments to vendors	(49,707)	(43,602)
Payments to employees	(11,354)	(14,427)
Other disbursements	<u>(406,188)</u>	<u>(356,334)</u>
Net cash provided by operating activities	228,356	80,330
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from issuance of bonds	414,736	46,765
Principal repayments on bonds	(527,230)	(226,585)
Interest paid	<u>(92,602)</u>	<u>(104,675)</u>
Net cash used in noncapital financing activities	(205,096)	(284,495)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investment securities	(1,147,149)	(301,295)
Proceeds from sale and maturities of investment securities	1,103,117	290,090
Investment income received	<u>13,392</u>	<u>10,469</u>
Net cash used in investing activities	<u>(30,640)</u>	<u>(736)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(7,380)	(204,901)
CASH AND CASH EQUIVALENTS—BEGINNING OF YEAR	<u>151,586</u>	<u>356,487</u>
CASH AND CASH EQUIVALENTS—END OF YEAR	<u>\$ 144,206</u>	<u>\$ 151,586</u>

(Continued)

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2003 AND 2002

(In Thousands of Dollars)

	2003	2002
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income	\$ 51,885	\$ 27,659
Adjustments to reconcile excess of revenue over expenses to net cash provided by operating activities:		
Amortization of deferred items—net	(16,439)	(13,513)
Arbitrage rebate expense	(9,251)	6,799
Investment income	(22,783)	(29,598)
Increase in realized and unrealized gain on market value of investments	2,638	(1,351)
Interest expense on bonds	93,546	108,374
Provision for possible losses on loans	10,152	1,095
Changes in assets and liabilities:		
Accrued interest—loans receivable	(1,493)	(25)
Loans receivable	119,185	(13,512)
Other assets	(11,227)	2,246
Escrow funds	9,337	19,678
Other liabilities	<u>2,806</u>	<u>(27,522)</u>
Net cash provided by operating activities	<u>\$ 228,356</u>	<u>\$ 80,330</u>

NONCASH FINANCING AND INVESTING ACTIVITIES—During the years ended June 30, 2003 and 2002, the Authority foreclosed on various properties with mortgage values of approximately \$8.3 million and \$6.6 million, respectively.

See notes to financial statements.

(Concluded)

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2003 AND 2002

1. AUTHORIZING LEGISLATION

The Michigan State Housing Development Authority (the “Authority”) was created by the Michigan legislature under the provisions of the State Housing Development Authority Act of 1966, as amended (the “Act”). The Authority, as a special purpose entity engaged in business type activities, is a component unit of the State of Michigan and is reflected as an enterprise fund in the State’s Comprehensive Annual Financial Report. The Act empowers the Authority, among other things, to issue notes and bonds to finance housing for sale or rental to families with low and moderate income and to finance home improvements. The enabling legislation, along with the various bond and note resolutions adopted by the Authority, contain specific provisions pertaining to (a) the use of the proceeds from the sale of the notes and bonds, (b) the application of the revenues from mortgages, and (c) the creation of certain funds along with the accounting policies for such funds. As of June 30, 2003, the Authority is authorized by statute to have notes and bonds outstanding up to a total of \$4.2 billion.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—The Authority’s financial statements have been prepared on the basis of the governmental proprietary fund concept which pertains to financial activities that operate in a manner similar to private business enterprises and are financed through fees and charges assessed primarily to the users of the services. The Authority applies all applicable Governmental Accounting Standards Board (“GASB”) pronouncements, as well as all Financial Accounting Standards Board (“FASB”) Statements and Interpretations, Accounting Principles Board (“APB”) Opinions, and Accounting Research Bulletins (“ARB”) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. After November 30, 1989, the Authority only applies applicable GASB pronouncements.

New Accounting Standard—In May 2002, the GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, an amendment of GASB Statement No. 14. The Authority will adopt GASB Statement No. 39 effective July 1, 2003. The Authority has determined that the adoption of GASB Statement No. 39 will not have a material effect on the Authority’s results of operations or financial position.

Restricted Assets—Substantially all of the assets of the Authority are pledged for payment against the various bond indentures.

Cash and Cash Equivalents—For purposes of the statements of cash flows, the Authority considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Investments—Investments are carried at fair value based on quoted market prices. The collateralized and uncollateralized investment agreements are not transferable and are considered nonparticipating contracts. As such, both types of investment agreements are carried at contract value. The net increase (decrease) in the fair value of investments includes both realized and unrealized gains and losses.

Multi-Family Mortgage Loans Receivable—Multi-family mortgage loans receivable consist of the remaining principal due from mortgagors of each completed development and construction advances for each development under construction under the multi-family program. Housing developments securing multi-family loans are subject to regulatory agreements under which the Authority has certain powers relating to rents, cash distributions, occupancy, management, and operations. Monies representing escrow funds for reserves for the payment of property taxes, insurance, property repairs and replacements, and income in excess of allowable cash distributions are required to be deposited with the Authority. Investment income earned on the deposited funds is credited to the respective mortgagors' escrow accounts.

Allowance for Possible Losses on Loans Receivable—It is the Authority's policy to provide for future losses on mortgage loans based on an evaluation of the loan portfolio and of current economic conditions and such other factors which, in the Authority's judgment, require consideration in estimating future mortgage loan losses. The allowance is maintained at a level considered by management to be adequate to provide for probable mortgage loan losses inherent in the portfolio.

Mortgage Discount, Loan and Origination Costs—Mortgage discount, loan and origination costs are deferred and recognized as income or expense over the life of the related loan using the interest method.

Bond Financing Costs—The costs of issuing bonds, other than bond discount, are capitalized and are classified as unamortized bond financing costs in the accompanying balance sheets. They are amortized to expense using the interest method over the life of the related debt.

Bond Discount—The discounts incurred on bonds issued are deferred and amortized to interest expense using the interest method. Such unamortized discounts are netted against bonds payable in the balance sheets.

Compensated Absences—Authority employees accrue vacation and sick leave in varying amounts for each biweekly period worked. Employees may accumulate, subject to certain limitations, vacation and sick leave, and upon retirement, termination, or death may be compensated for certain accumulated amounts at their then current rates of pay. The Authority records an expense for all accumulated vacation and sick leave that the Authority would be required to pay if all employees terminated their employment. The accrued liabilities at June 30, 2003 and 2002 were \$1,757,000 and \$3,087,000, respectively.

Bond Financing Fees—The Authority charges the mortgagor of each multi-family development a financing fee, equal to 2% of the mortgage loan and, for certain loans, charges a credit enhancement fee equal to 3% of the mortgage loan. These fees and the associated direct costs are deferred and recognized to mortgage interest income over the life of the loan using the interest method.

The Authority charges special fees for certain Section 8 assisted mortgage loans to enable the Authority to earn its normal interest override on such mortgage loans. These fees are included in mortgage discount and are being recognized as mortgage interest income over the life of the related mortgage loans using the interest method.

In connection with the issuance of limited obligation bonds, the Authority generally assesses financing fees equal to either 1% or 2% of the amount of the bonds issued depending on the location of the project for original issuances and 0.25% for the refunding of limited obligation bonds. All fees received in excess of 1% are recorded as a liability as they are required to be used to assist projects located in eligible distressed areas.

Arbitrage Rebate—Federal income tax rules limit the investment and loan yields which the Authority may retain for its own use from investing the proceeds from certain of its tax-exempt bond issues. The excess yields are payable to the U.S. Treasury and are accrued in the accompanying statements of financial position and included in deferred mortgage interest income and other liabilities.

Section 8 Program—The Authority is the administrator of various Section 8 housing programs in Michigan for the U.S. Department of Housing and Urban Development. The Authority receives federal financial assistance to provide rental subsidies to the tenants of various housing developments and for program administration costs. During the years ended June 30, 2003 and 2002, the Authority received approximately \$202,968,000 and \$171,307,000 and disbursed approximately \$207,570,000 and \$163,400,000, respectively, in rental subsidies. Of the amounts disbursed, \$96,733,000 and \$65,613,000 were processed by the Authority on behalf of program participants and are reflected as a revenue and expense item on the Authority's Statements of Revenue and Expenses and Changes in Fund Equity for the years ended June 30, 2003 and 2002, respectively. The remaining amounts were processed by the Authority as a federal mortgage subsidy for multi-family housing projects and have been included in the accompanying financial statements as interest income and reduction of principal in mortgage loans receivable. In addition, the Authority receives an administrative fee for these services on a portion of the units administered under this program based on the number of units serviced.

Operating Revenues and Expenses—The Authority was created with the authority to issue bonds to the investing public in order to create a flow of private capital through the Authority into mortgage loans to qualified housing sponsors and to certain qualified individuals. The Authority's primary operation is to borrow funds in the bond market and use those funds to make single-family and multi-family loans. Its primary operating revenue is derived from the investment income from proceeds of bond funds. The primary cost of the program is interest expense on bonds outstanding. Net investment income is an important measure of performance under the Authority's primary operation. Investment income, interest expense and net investment income are shown as operating revenues in the Statements of Revenue and Expenses and Changes in Fund Equity.

Project Reserves and Preservation Fees—The Authority enters into agreements with certain development owners, whereby the owners agree to preserve the developments for occupancy by low-income families. Under the terms of the original loan agreement, the development owner is restricted as to the rate of return on their original investment. Amounts received in excess of the allowable return are held by the Authority as a reserve for the project. During the life of the loan, the Authority records such reserves as a liability, which is included in escrow funds on the Authority's balance sheet. Upon termination of the loan, any excess reserves are recognized as revenues and are included in other income. From time to time, the Authority allows the development owners to borrow a portion of the developments' excess reserves as a part of a preservation agreement.

3. DEPOSITS AND INVESTMENTS

Deposits—At June 30, 2003 and 2002, the carrying amount of the Authority's bank deposits, including certificates of deposit and money market accounts, was \$95,692,000 and \$51,545,000, and the bank balance was \$99,314,000 and \$55,548,000, respectively. Of the bank balance, \$715,000 and \$518,000 for 2003 and 2002 was covered by federal depository insurance, \$2,063,000 and \$2,746,000 was collateralized, \$651,000 and \$578,000 was uninsured and uncollateralized, and \$95,885,000 and \$51,706,000, respectively, was held in money market accounts.

Investments—Statutes authorize the Authority to invest, at the discretion of the Authority, funds held in reserve or sinking funds, or monies not required for immediate use or disbursement, in obligations of the State of Michigan or of the United States, in obligations of which the principal and interest are

guaranteed by the State of Michigan or the United States, or in other obligations approved by the State Treasurer.

Cash, cash equivalents and investments held by the Authority at June 30 were as follows (in thousands of dollars):

	2003		2002	
	Amortized Cost	Carrying Value	Amortized Cost	Carrying Value
Cash	\$ (2,182)	\$ (2,182)	\$ (2,134)	\$ (2,134)
Certificates of deposit	1,989	1,989	1,973	1,973
Government money market funds	95,885	95,885	51,706	51,706
Repurchase agreements	500	500		
U.S. Government securities	171,497	199,356	145,748	162,897
Mortgage-backed securities	98,988	103,844	172,750	177,182
U.S. Government agency securities	229,753	240,767	235,092	240,909
Investment agreements	138,420	138,420	116,626	116,626
Michigan Broadband Authority	<u>49,800</u>	<u>46,555</u>	<u>16,667</u>	<u>16,667</u>
Subtotal	784,650	825,134	738,428	765,826
Accrued interest	<u>3,812</u>	<u>3,812</u>	<u>4,022</u>	<u>4,022</u>
Total	<u>\$788,462</u>	<u>\$828,946</u>	<u>\$742,450</u>	<u>\$769,848</u>

The amortized cost and estimated market value of cash, cash equivalents, and investments at June 30, 2003, by contractual maturity, are shown below (in thousands of dollars). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Carrying Value
Due in one year or less	\$ 295,458	\$ 295,458
Due one year through five years	15,430	18,682
Due after five years through ten years	22,910	30,845
Due after ten years	<u>351,864</u>	<u>376,305</u>
Subtotal	685,662	721,290
Mortgage-backed securities	<u>98,988</u>	<u>103,844</u>
Total	<u>\$ 784,650</u>	<u>\$ 825,134</u>

Proceeds from the sales of investments in debt securities in 2003 and 2002 were \$593,812,000 and \$154,246,000, respectively. Those sales had realized gains of \$5,768,000 and \$1,721,000 in 2003 and 2002, respectively. The calculation of realized gains is independent of the calculation of the net increase in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net change in the fair value of investments during 2003 and 2002 was a \$13,086,000 increase and a \$10,108,000 increase, respectively. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year.

Included in cash and investments are funds held in trust for mortgagors with a carrying value of \$358,026,000 and \$375,903,000 at June 30, 2003 and 2002, respectively, and amortized cost of \$331,725,000 and \$362,896,000 at June 30, 2003 and 2002, respectively.

The Authority's investments are categorized below (in thousands of dollars) to give an indication of the level of risk assumed by the entity at June 30, 2003 and 2002. Category 1 includes investments that are insured or registered or for which the securities are held by the Authority's agent in the Authority's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered investments for which the securities are held by banks, brokers or dealers, or by their agents, but not in the Authority's name. Not categorized includes certain other investments, such as certificates of deposit, government money market funds, repurchase agreements, and investment agreements, as they are not evidenced by securities that exist in physical or book entry form.

	2003				
	Category			Not Categorized	Carrying Amount
	1	2	3		
U.S. Government securities	\$ 199,356	\$ -	\$ -	\$ -	\$ 199,356
Mortgage-backed securities	91,405	902	11,537		103,844
U.S. Government-backed securities			240,767		240,767
Noncategorized deposits and investments				281,167	281,167
Total	<u>\$ 290,761</u>	<u>\$ 902</u>	<u>\$ 252,304</u>	<u>\$ 281,167</u>	<u>\$ 825,134</u>

	2002				
	Category			Not Categorized	Carrying Amount
	1	2	3		
U.S. Government securities	\$ 162,897	\$ -	\$ -	\$ -	\$ 162,897
Mortgage-backed securities	134,860		42,322		177,182
U.S. Government-backed securities			240,909		240,909
Noncategorized deposits and investments				184,838	184,838
Total	<u>\$ 297,757</u>	<u>None</u>	<u>\$ 283,231</u>	<u>\$ 184,838</u>	<u>\$ 765,826</u>

4. LOANS RECEIVABLE

All loans receivable are collateralized by first liens on the real property developed or purchased with the proceeds of the loans, except for certain home improvement and moderate rehabilitation loans. Substantially all single-family loans are insured by the Federal Housing Administration ("FHA") or private mortgage insurance companies, or are guaranteed by the Veterans Administration ("VA") or by the United States Department of Agriculture. Substantially all multi-family loans are uninsured.

A summary of loans receivable are as follows (in thousands of dollars):

	<u>June 30</u> <u>2003</u>	<u>June 30</u> <u>2002</u>
Loans receivable:		
FHA insured, VA, or Department of Agriculture guaranteed	\$ 465,524	\$ 562,048
Insured by private mortgage insurance companies	84,262	103,852
Uninsured	<u>1,291,082</u>	<u>1,294,154</u>
Total	<u>\$1,840,868</u>	<u>\$1,960,054</u>

A summary of the allowance for possible losses is as follows:

	2003	2002
Beginning balance	\$ 33,000	\$ 32,000
Provision for possible losses on loans	10,152	1,095
Write-offs of uncollectible losses, net of recoveries	<u>(152)</u>	<u>(95)</u>
Ending balance	<u>\$43,000</u>	<u>\$33,000</u>

5. GENERAL OBLIGATION BONDS PAYABLE

The Authority issues general obligation bonds to provide loans to finance multi-family housing projects, single-family housing units, and home improvements for persons of low and moderate income within the State of Michigan. Such bonds constitute a direct obligation of the Authority and are not a debt of the State of Michigan. Each bond issue is secured by the pledge of all repayments to the Authority of loans issued with the proceeds of the bond issue, and all income earned by the Authority relating to those bonds. Interest on all bonds, except capital appreciation bonds, is payable semi-annually. Capital appreciation bonds are bonds that are issued at a deep discount and for which all interest is accrued and paid at retirement. The Authority amortizes the discount using the interest method over the terms of the bonds. Capital appreciation bonds in the following table are shown net of unamortized discount. All bonds are subject to a variety of redemption provisions as set forth in the official statements for each of the issues. One such redemption provision is that each of the Bond Resolutions contains cross-default provisions which permit the acceleration of the maturity of all such bonds, as well as certain other remedies, in the event of a default by the Authority in the payment of principal or interest on any bond of the Authority.

Bonds payable at June 30 are as follows (in thousands of dollars):

	2003	2002
Single-Family Insured Mortgage Revenue Bonds—		
1978 Series A, 2005 to 2010, 5%	\$ 7,420	\$ 7,420
Section 8 Assisted Mortgage Revenue Bonds—		
1983 Series I, 2009 to 2014, 10.875% *	10,084	9,071
Single-Family Mortgage Revenue Bonds:		
1991 Series B, 2002 to 2005, 6.20% to 6.50%		6,005
1992 Series A, 2002 to 2005, 6.25% to 6.55%		10,840
1994 Series A, 2003 to 2011, 5.70% to 6.35%	12,015	18,390
1994 Series C and D, 2003 to 2011, 5.70% to 6.38%	5,590	13,250
1995 Series A, 2003 to 2008, 6.00% to 6.45%	7,155	20,730
1995 Series C and D, 2003 to 2016, 5.05% to 6.00%	26,850	39,030
1996 Series A, B and C, 2003 to 2027, 5.35% to 6.05%	95,010	103,005
1996 Series D and E, 2003 to 2027, 5.10% to 6.20%	33,930	49,735
1997 Series A, 2003 to 2028, 5.00% to 5.75%	26,570	36,445
1997 Series C, D and E, 2003 to 2028, 4.75% to 6.87%		
including \$12,580 at a variable rate	57,080	74,195
1998 Series B and C, 2003 to 2030, 4.10% to 5.20%	64,535	74,075
1999 Series A, 2003 to 2029, 5.25% to 6.30%	14,555	14,830
1999 Series B-1, 2003 to 2029, 5.25% to 6.375%	13,860	21,235
1999 Series B-2, 2024, variable rate (Note 6)	12,850	12,850
2000 Series A, 2016, variable rate (Note 6)	27,710	27,710
2000 Series B, 2003 to 2020, 5.25% to 6.30%	1,785	6,675
2000 Series C, 2020, variable rate (Note 6)	40,000	40,000
2001 Series A, 2003 to 2032, 3.70% to 5.55%	101,110	102,835
2001 Series B, 2002, variable rate		24,365
2002 Series A, 2002, variable rate (Note 6)	15,000	15,000
2002 Series B, 2005 to 2030, 3.25% to 5.50%	7,615	7,615
2002 Series C, 2030, variable rate (Note 6)	20,000	
2002 Series D, 2003, variable rate	41,375	
2003 Series A, 2004, variable rate	31,030	
	655,625	718,815
Multi-Family Housing Revenue Bonds—		
1988 Series A, 2003 to 2019, variable rate (Note 6)	47,800	49,200
Rental Housing Revenue Bonds:		
1992 Series A		143,905
1993 Series A		147,965
1994 Series B, 2002 to 2019, 5.00% to 5.80%	76,085	80,285
1995 Series A and B, 2003 to 2015, 5.30% to 6.15%	71,710	103,620
1997 Series A, 2003 to 2033, 5.00% to 6.10%	80,590	81,975
1997 Series B, 2003 to 2009, variable rate (Note 6)	30,190	32,250
1999 Series A, B and C, 2003 to 2037, 3.75% to 5.30%	91,530	102,145
1999 Series D, 2003 to 2015, variable rate	46,150	50,000
2000 Series A and B, 2024 and 2035, variable rate (Note 6)	80,795	92,050
2001 Series A, B and C, 2023 to 2035, variable rate	147,075	150,270
2002 Series A, B and C, 2019 to 2037, variable rate (Note 6)	182,665	
2003 Series A, 2023, variable rate	132,745	
	939,535	984,465
Insured Rental Housing Revenue Bonds—		
1998 Series A, 2008 to 2026, 6.325% to 6.89%	36,650	37,255
Multi-Family Revenue Bonds—		
1995 Series A, 2004 to 2030, 7.85% to 8.55%	32,550	32,925
Subtotal	1,729,664	1,839,151
Less bond discount—net of amortization	16,599	10,312
Total	<u>\$ 1,713,065</u>	<u>\$ 1,828,839</u>

A portion of the bonds indicated with an asterisk (*) above is capital appreciation bonds ("CAB"). A CAB is a debt instrument that is satisfied with a single payment when retired, representing both the initial principal amount and the total investment return.

The following summarizes principal and interest debt service requirements at June 30, 2003 for the next 36 fiscal years (in thousands of dollars):

Fiscal Year	Principal	Interest	Total
2004	\$ 123,115	\$ 84,798	\$ 207,913
2005	58,295	81,752	140,047
2006	62,760	78,927	141,687
2007	67,910	75,874	143,784
2008	<u>68,665</u>	<u>72,566</u>	<u>141,231</u>
Total Fiscal Years 2003-2007	380,745	393,917	774,662
2009-2013	389,695	309,832	699,527
2014-2018	353,399	213,907	567,306
2019-2023	250,850	130,906	381,756
2024-2028	189,820	72,027	261,847
2029-2033	119,235	25,457	144,692
2034-2038	<u>45,920</u>	<u>4,608</u>	<u>50,528</u>
Total Fiscal Years 2009-2038	<u>1,348,919</u>	<u>756,737</u>	<u>2,105,656</u>
Total	<u>\$ 1,729,664</u>	<u>\$ 1,150,654</u>	<u>\$ 2,880,318</u>

Under provisions of the Authority's bond issues, the Authority is able to retire bonds, without the payment of call premiums, prior to their maturity dates from the proceeds of loan prepayments and foreclosures and, for certain bonds, from excess program revenues. Bonds retired pursuant to such provisions total \$213,805,000 and \$145,870,000 during the years ended June 30, 2003 and 2002, respectively. Such bond retirements, in the aggregate, resulted in net gains (losses) of \$412,000 and \$(65,000) for the years ended June 30, 2003 and 2002, respectively. These gains represent net adjustments to unamortized bond discounts, net of the write-off of related unamortized issuance costs, and are recorded in interest expense and debt financing costs in the Statements of Revenue and Expenses and Changes in Fund Equity.

6. DEMAND BONDS

Included in bonds payable at June 30, 2003 are \$60,000,000, \$49,225,000 and \$73,440,000 of Rental Housing Revenue Bonds, 2002 Series A, B and C, respectively. The proceeds of the Series A Bonds are being used to fund new multi-family mortgage loans. The proceeds of the Series B and C Bonds were issued to refund the Rental Housing Revenue Bonds, 1992 Series A. The 2002 Series A, B and C Bonds are subject to purchase on the demand of the holders, at a price equal to principal plus accrued interest, on delivery to the Authority's remarketing agent, Goldman Sachs & Co. The remarketing agent is required to use its best efforts to resell the bonds at a price equal to 100% of the principal amount and may adjust the interest rate in order to do so. If the remarketing agent is unsuccessful in remarketing the bonds, Landesbank Hessen-Thüringen Girozentrale ("Helaba") will purchase such bonds pursuant to a Standby Bond Purchase Agreement between Helaba, the Trustee and the Authority. Such agreement is currently valid through June 29, 2004. While Helaba is holding the bonds, they will bear interest at the higher of Helaba's prime rate or the Federal Funds Rate plus 0.50% per annum. Once Helaba becomes the owner of the bonds, the bonds will be subject to a mandatory redemption that begins 90 days after

Helaba becomes the holder of the bonds and is amortized in 20 equal quarterly installments. The Authority is required to pay Helaba an annual commitment fee of 0.17% per annum on the amount of bonds outstanding plus interest for 34 days at a rate of 14%. In addition, the remarketing agent receives a fee equal to one-tenth of 1% of the outstanding principal amount of the bonds outstanding.

Included in bonds payable at June 30, 2003, are \$47,570,000 and \$33,225,000 of Rental Housing Revenue Bonds, 2000 Series A and 2000 Series B, respectively. The proceeds of the Series A Bonds were used to fund new multi-family mortgage loans. The proceeds of the Series B Bonds were issued to refund an equal amount of Rental Housing Revenue Bonds, 1997 Series B (see next paragraph). The 2000 Series A and Series B Bonds are subject to purchase on the demand of the holders, at a price equal to principal plus accrued interest, on delivery to the Authority's remarketing agent, Goldman Sachs & Co. The remarketing agent is required to use its best efforts to resell the bonds at a price equal to 100% of the principal amount and may adjust the interest rate in order to do so. If the remarketing agent is unsuccessful in remarketing any bonds, Morgan Guaranty Trust Company of New York (the "Bank") shall purchase such bonds pursuant to a Standby Bond Purchase Agreement between the Bank, the Trustee and the Authority. Such agreement is currently valid through September 28, 2005. While the bonds are held by the Bank they shall bear interest at the higher of the Bank's prime rate or 0.50% per annum above the Federal Funds Rate and will be subject to mandatory redemption in ten equal semi-annual installments commencing between six and twelve months after being acquired by the Bank. The Authority is required to pay the Bank an annual commitment fee of 0.20% per annum on the amount of bonds outstanding plus interest for 34 days at a rate of 14%. In addition, the remarketing agent receives a fee equal to one-tenth of 1% of the outstanding principal amount of the bonds.

Included in bonds payable at June 30, 2003, is \$30,190,000 of General Obligation Rental Housing Revenue Bonds, 1997 Series B, with semi-annual sinking fund requirements through April 1, 2019. The proceeds of the bonds were used to refund an equal amount of 1994 Series C Rental Housing Revenue Bonds, which in turn were issued to refund Section 8 Assisted Mortgage Revenue Bonds and a portion of the Rental Housing Revenue Bonds, 1992 Series B. The 1997 Series B Bonds are subject to purchase option on the demand of the holder, at a price equal to principal plus accrued interest on delivery to the Authority's remarketing agent, Goldman Sachs & Co. The remarketing agent is required to use its best efforts to resell the bonds at a price equal to 100% of their principal amount and may adjust the interest rate in order to do so. If the remarketing agent is unsuccessful in remarketing any bonds, they are to be delivered to the Trustee for payment. The Trustee is entitled to draw on an irrevocable letter of credit, issued by Helaba, an amount sufficient to pay the purchase price of bonds delivered to it. The letter of credit is valid through April 11, 2004. The Authority must repay the bank for each draw on the letter of credit by its expiration date. Interest is also payable on any of these draws outstanding at a variable rate not to exceed 12%. The Authority is required to pay the bank an annual commitment fee for the letter of credit of 0.25% per annum of the amount of the letter of credit, which is equal to the amount of bonds outstanding plus interest for 211 days at 12% per annum. In addition, the remarketing agent receives an annual fee equal to one-eighth of 1% of the outstanding principal amount of the bonds.

Included in bonds payable at June 30, 2003, is \$15,000,000 and \$40,000,000 of Single-Family Mortgage Revenue Bonds, 2002 Series A and 2002 Series C, respectively. The bonds were issued to finance the purchase of new single-family mortgage loans. The bonds are subject to purchase on the demand of the holders, at a price equal to principal plus accrued interest, on delivery to the Authority's remarketing agent, Lehman Brothers. The remarketing agent is required to use its best efforts to resell the bonds at a price equal to 100% of the principal amount and may adjust the interest rate in order to do so. If the remarketing agent is unsuccessful in remarketing any of the bonds, Helaba shall purchase such bonds pursuant to a standby bond purchase agreement between Helaba, the Trustee and the Authority. Such agreement is currently valid through May 26, 2004 for the Series A Bonds and September 29, 2004 for the Series C Bonds. While the bonds are held by Helaba, they shall bear interest at a rate per annum

equal to the higher of (a) Federal Funds Rate plus 0.50% or (b) prime rate, and will be subject to mandatory redemption by the Authority on a quarterly basis beginning six months and ending five years after their purchase by Helaba. The Authority is required to pay an annual commitment fee of 0.14% per annum on the amount of bonds outstanding plus interest for 183 days at a rate of 14% per annum. In addition, the remarketing agent receives a fee equal to one-tenth of 1% of the outstanding principal amount of the bonds.

Included in bonds payable at June 30, 2003, are \$12,850,000, \$27,710,000 and \$40,000,000 of Single-Family Mortgage Revenue Bonds, 1999 Series B-2, 2000 Series A and 2000 Series C, respectively. The proceeds of the 2000 Series A Bonds were used to refund the Authority's 1990 Series A Single-Family Mortgage Revenue Bonds and the proceeds of the 1999 Series B-2 and 2000 Series C Bonds were used to finance the purchase of new single-family mortgage loans. The bonds are subject to purchase on the demand of the holders, at a price equal to principal plus accrued interest, on delivery to the Authority's remarketing agent, Lehman Brothers. The remarketing agent is required to use its best efforts to resell the bonds at a price equal to 100% of the principal amount and may adjust the interest rate in order to do so. If the remarketing agent is unsuccessful in remarketing any of the bonds, Bank One Michigan ("Bank One") shall purchase such bonds pursuant to a Standby Bond Purchase Agreement between Bank One, the Trustee and the Authority. Such agreement is currently valid through June 1, 2005. While the bonds are held by Bank One they shall bear interest at a rate determined in reference to the British Bankers' Association Interest Settlement Rate, as adjusted for Bank One's Reserve Requirement, plus 0.70%, and will be subject to mandatory redemption by the Authority on a quarterly basis beginning six months and ending five years after their purchase by Bank One. The Authority is required to pay an annual commitment fee of 0.115% per annum on the amount of bonds outstanding plus interest for 205 days at a rate of 14% per annum. In addition, the remarketing agent receives a fee equal to one-tenth of 1% of the outstanding principal amount of the bonds.

Included in bonds payable at June 30, 2003, is \$47,800,000 of General Obligation Multi-Family Housing Revenue Bonds (1988 Series A) with annual sinking fund requirements through November 1, 2019. The proceeds of the bonds were used to (a) provide funds for multi-family mortgage loans, (b) establish reserve funds in accordance with the trust agreement and (c) pay costs incurred to issue the bonds. The bonds are subject to purchase on the demand of the holders at a price equal to principal plus accrued interest on delivery to the Authority's remarketing agent, Merrill Lynch, Pierce, Fenner & Smith Incorporated. The remarketing agent is required to use its best efforts to resell the bonds at a price equal to 100% of their principal amount and may adjust the interest rate in order to do so. If the remarketing agent is unsuccessful in remarketing any bonds, they are to be delivered to the Trustee for payment. The Trustee is entitled to draw on an irrevocable letter of credit, issued by Helaba, an amount sufficient to pay the purchase price of bonds delivered to it. The letter of credit is valid through March 31, 2008. The Authority must repay Helaba for each draw on the letter of credit by its expiration date. Interest is also payable on any draws outstanding at a rate equal to the lesser of (a) the greater of Helaba's prime rate or the Federal Funds Rate plus 0.50% or (b) 25%. The Authority is required to pay Helaba an annual commitment fee for the letter of credit of 0.28% per annum of the amount of the letter of credit, which is equal to the amount of bonds outstanding plus interest for 41 days at 25% per annum. In addition, the remarketing agent receives an annual fee equal to one-eighth of 1% of the outstanding principal amount of the bonds.

7. LIMITED OBLIGATION BONDS

The Act, as amended, authorizes the Authority to issue limited obligation bonds to finance multi-family housing. Such bonds are not general obligations of the Authority and the Authority has no liability for this debt. Such bonds are secured solely by revenues and property derived from or obtained in connection with the housing projects. Thus, with the exception of limited obligation bond financing fees discussed in Note 2, transactions related to these bonds are not reflected in the Authority's financial statements. At June 30, 2003, limited obligation bonds had been issued totaling approximately \$525,188,000 of which ten issues totaling \$77,598,000 have been retired.

8. PENSION PLAN

Plan Description—The employer's share of life, health, optical, dental, and long-term disability insurance premiums are charged by the State of Michigan to the Authority biweekly based on each employee's selected coverage.

The Authority's employees are also enrolled in a noncontributory Defined Benefit Plan or a Defined Contribution Plan through the State Employee's Retirement System upon meeting certain eligibility requirements. The Defined Benefit Plan provides for retiree pension, dental, vision, and major medical coverage. The Defined Contribution Plan provides for a 4% gross pay contribution to the participant's plans, and to which participants may contribute up to 18% of their salary. The State matches the first 3% of participant contributions. All new employees after March 31, 1997 are members of the Defined Contribution Plan. In 1997, when the Defined Contribution Plan was adopted, participants in the Defined Benefit Plan had a one-time irrevocable choice to continue in that Plan or convert to the Defined Contribution Plan. The cost of these benefits is allocated to the Authority as a percentage of gross payroll.

A member of the Defined Benefit Plan may retire with an age and service allowance after completing: (1) at least ten years of credited service and (2) attaining the minimum retirement age of 60, or at least age 55 with 30 years of service credit. The normal retirement benefit is payable for the lifetime of a member and is determined using 1.5% times a member's final average compensation multiplied by the number of years of credited service. Final average compensation is calculated as the average of a member's monthly pay during the period of 36 consecutive months of credited service producing the highest monthly average.

Pension costs of the Authority paid into the Plan aggregated \$1,962,000 and \$1,925,000 for the years ended June 30, 2003 and 2002, respectively, and are included in salaries and benefits expense. The Authority has no liability for pension costs other than the normal contributions as determined by the Plan.

Additional detail and data regarding the Plan description, accounting policies, vesting and eligibility requirements, actuarial cost methods and assumptions, funding status and requirements, and ten-year historical trend information is provided in the State of Michigan Comprehensive Annual Financial Report and the Plan's detailed financial reports, issued by the Bureau of Retirement Systems.

9. DEFERRED MORTGAGE INTEREST INCOME

Since 1990, the Authority has refunded a substantial amount of high yielding multi-family bond issues with lower yielding bonds. In conjunction with the sale of certain of the refunding bonds, the Authority has sold additional bonds to provide funds for new multi-family mortgage loans, generally with interest rates below the interest rates on the bonds. The Authority is deferring the interest income on mortgage loans funded by the new bonds to the extent that the total thereof exceeds the total interest income that would have been earned if the average interest rate on such loans was equal to the average interest rate paid on the new bonds plus approximately 1.5%. This deferred interest income is and will continue to be amortized to income in the future as the average rate on the outstanding mortgage loans drops to a rate that is less than 1.5% above the average rate on the new bonds. The average rate will decline primarily because the higher yielding mortgage loans have average remaining lives substantially shorter than the lower yielding mortgage loans. The mortgage interest income that was deferred, net of amortization, was \$14,120,000 and \$4,670,000 for the years ended June 30, 2003 and 2002, respectively.

10. CAPITAL LEASE

Effective April 2001, the Authority entered into an agreement to lease its building through the year 2021. The Authority has purchase options at the end of five or ten years respectively, equal to the present value of the future lease payments. Based upon a review of the lease terms, the Authority has determined that such lease is a capital lease. Accordingly, the land and building has been recorded as a capital asset of the Authority, totaling \$13,746,508 with accumulated depreciation of \$1,351,012 at June 30, 2003, and is included in other assets.

Future minimum lease payments under the scheduled capital lease that have initial or remaining non-cancelable terms in excess of one year are as follows:

Fiscal Year	Principal	Interest	Total
2004	\$ 393,836	\$ 1,085,664	\$ 1,479,500
2005	425,170	1,054,330	1,479,500
2006	458,997	1,020,503	1,479,500
2007	495,516	983,984	1,479,500
2008	<u>534,940</u>	<u>944,560</u>	<u>1,479,500</u>
Total Fiscal Years 2004-2008	2,308,459	5,089,041	7,397,500
2009-2013	3,385,009	4,012,492	7,397,501
2014-2018	4,963,608	2,433,892	7,397,500
2019-2021	<u>3,780,486</u>	<u>411,431</u>	<u>4,191,917</u>
Total Fiscal Years 2004-2021	<u>\$14,437,562</u>	<u>\$11,946,856</u>	<u>\$26,384,418</u>

11. RESTRICTED FUND EQUITY

The components of restricted fund equity are as follows (in thousands of dollars):

	<u>June 30</u> <u>2003</u>	<u>June 30</u> <u>2002</u>
Pledged for payment of:		
All bond issues (Capital Reserve Capital Account)	\$ 41,480	\$ 37,351
Section 8 Assisted Mortgage Revenue Bonds	12,920	12,975
Single-Family Insured Mortgage Revenue Bonds	3,970	3,399
Home Improvement Program Bonds	6,324	6,192
Single-Family Mortgage Revenue Bonds	60,748	54,323
Multi-Family 1988 Housing Revenue Bonds	415	742
Rental Housing Revenue (Tax-Exempt) Bonds	106,887	78,085
1992 and 1998 Insured Rental Housing Revenue Bonds	7,340	6,940
Multi-Family 1995 Series A Revenue Bonds	<u>2,193</u>	<u>1,740</u>
Total	<u>\$ 242,277</u>	<u>\$ 201,747</u>

12. CONTINGENCIES

The Authority is involved in various legal proceedings, claims and disputes arising in the ordinary course of its financing activities with real estate developers and others. Management does not expect the amount of the ultimate liability with respect to the disposition of these matters will have any material adverse impact on the financial condition or results of operations of the Authority.

13. COMMITMENTS

As of June 30, 2003 and 2002, the Authority has commitments to issue multi-family mortgage loans in the amounts of \$104,786,000 and \$58,451,000, respectively, and single-family mortgage loans in the amounts of \$9,828,000 and \$18,660,000, respectively.

The Authority has committed up to approximately \$1,055,000 per year for up to 30 years from the date of completion of the respective developments (subject to three years advance notice of termination) from its accumulated reserves and future income to subsidize operations or rents for certain tenants occupying units in certain developments funded under the Authority's multi-family program. Such developments receive funds either for the purpose of subsidizing rents so that some units can be afforded by families with incomes at 50% or less of median income or to subsidize operations in general. Subsidy disbursements began in 1985 and totaled approximately \$611,000 and \$639,000 for the years ended June 30, 2003 and 2002, respectively.

In addition, the Authority makes available up to approximately \$1,000,000 per year for up to 30 years to subsidize rents in a similar fashion for 20% of the units in certain other developments financed or to be financed under its multi-family mortgage lending program. Under this program, the Authority is entitled to receive a portion of any excess cash flow generated by the developments as well as a share of the profits from the sale of the developments and is able to reduce the rent subsidies if the interest rates being charged by the Authority on the related mortgage loans are below certain preset levels. Subsidy repayments exceeded subsidy disbursements by \$34,000 and \$63,000 for the years ended June 30, 2003 and 2002, respectively.

In conjunction with a multi-family taxable bond lending program, the Authority is making available annually to certain developments financed under the program an amount equal to 400 times the number of units in such developments (subject to a one year advance notice of termination) for the purpose of subsidizing rents so that some of the units in such developments can be made available to very low income tenants. Under certain circumstances, after 15 years or more, the owners of the developments will be required to repay without interest up to 100% of the subsidies provided by the Authority. The Authority has not established a maximum amount that it will make available under this program. Subsidy disbursements under this program totaled \$933,000 and \$940,000 for the years ended June 30, 2003 and 2002, respectively.

Finally, the Authority also makes available interest free loans of up to \$25,000 annually to developments that incur increased operating costs because of their small size (less than 100 rental units) and up to \$25,000 annually for developments that incur increased security costs due to their location. The loans are repayable from excess development revenues and are also repayable upon repayment of the first mortgage loan. Disbursements under this program totaled \$501,000 and \$517,000 for the years ended June 30, 2003 and 2002, respectively.

14. GRANTS AND SUBSIDIES

Disbursements under the programs described in Note 13 are included in grants and subsidies on the statements of revenues and expenses and changes in fund equity, along with grants made to non-profit organizations pursuant to various programs that have as their purpose increasing the supply of affordable housing for low and medium income families in Michigan and the provision of temporary shelter for homeless individuals and families.

15. OFF BALANCE SHEET FINANCIAL INSTRUMENTS

In connection with the issuance of various debt, the Authority has entered into interest rate swap contracts. To date, the interest rate swap contracts have all been the type where the Authority pays a fixed rate and receives a variable rate. No amount of compensation was paid or received at the time the contracts were executed. Interest rate swap agreements are important tools that the Authority utilizes to accomplish its goals. These contracts have reduced the Authority's cost of borrowing and reduced exposure to variable interest rate risk. This has allowed the Authority to finance developments, reduce single-family mortgage rates and fund programs that otherwise would not have been feasible.

The following summarizes the interest rate swap contracts at June 30, 2003:

Associated Debt/ Swap Agreement	Notional Amount as of June 30, 2003	Termination Date	Rate Receiving	Fixed Rate	Optional Termination Date	Market (Payment)/ to Terminate Swap	Type of Risk Associated with Swap Contract (3)(7)
Rental Housing							
Revenue Bonds (1):							
2000 Series A	\$ 47,570,000	October 1, 2020	70% of 1 M LIBOR	4.960%	Current	\$ (9,578,568)	(4)(5)(6)
2001 Series B	42,490,000	April 1, 2023	Actual Bond Rate	5.350%	Current	(7,442,708)	
2001 Series C	44,925,000	April 1, 2023	Actual Bond Rate	4.770%	Current	(5,443,628)	
2002 Series A	60,000,000	April 1, 2037	70% of 1 M LIBOR	4.560%	Current	(11,173,462)	(4)(5)
2002 Series B	49,225,000	April 1, 2019	70% of 1 M LIBOR	3.535%	Current	(3,332,446)	(4)(5)
2003 Series B	<u>80,000,000</u>	October 1, 2037	70% of 1 M LIBOR	4.197%	Current (8)	<u>(8,205,025)</u>	(4)(5)
subtotal	324,210,000					(45,175,837)	
Single-Family Mortgage							
Revenue Bonds (2):							
1999 Series B-2	12,850,000	December 1, 2018	Actual Bond Rate	5.489%	Current	(2,729,051)	(5)(6)
2000 Series A	13,750,000	December 1, 2016	Actual Bond Rate	5.439%	Current	(3,533,169)	(5)
2000 Series C	27,225,000	December 1, 2008	Actual Bond Rate	7.696%	Current	(4,140,918)	(6)
2002 Series A	<u>15,000,000</u>	June 1, 2020	Actual Bond Rate	3.860%	Current	<u>(1,285,497)</u>	(5)
subtotal	<u>68,825,000</u>					<u>(11,688,635)</u>	
Total	<u>\$ 393,035,000</u>					<u>\$ (56,864,472)</u>	

- 1) Counterparty risk is the risk that the swap counterparty will not fulfill its obligations set forth under the terms and conditions of the swap contract. The counterparty associated with these bonds is Goldman Sachs Mitsui Marine Derivative Products, L.P. ("GSMMDP"). GSMMDP is currently rated Aaa by Moody's and AA+ by S&P.
- 2) Counterparty risk is the risk that the swap counterparty will not fulfill its obligations set forth under the terms and conditions of the swap contract. The counterparty associated with these bonds is Lehman Brothers Derivative Product Inc. ("LBDP"). LBDP is currently rated Aaa by Moody's and AAA by S&P.
- 3) Termination risk is the risk that the swap could be terminated by the counterparty due to any of several events, which may include an Authority or counterparty ratings downgrade, covenant violation by either party, bankruptcy of either party, swap payment default by either party, and default events as defined in the Authority's bond indentures. All contracts have this risk.
- 4) Basis risk refers to a mismatch between the interest rate received from the swap contract and the interest actually paid on the Authority's debt.
- 5) Tax event risk is the risk that a change in the marginal income tax rates or a change in the tax code impacts the trading value of tax-exempt bonds.
- 6) Rollover risk is the risk that the swap contract is not coterminous with the related debt.
- 7) Amortization risk is the risk that there is a mismatch or potential mismatch between the Authority's bonds and the notional amount of the swap outstanding. This mismatch could expose the Authority to variable interest rates if the swap amortizes quicker than the bonds or subject the Authority to a payment to the counterparty to terminate a portion of the swap contract early if the bonds are redeemed quicker than anticipated. All contracts have this risk.
- 8) The Authority has the option to terminate the contract in whole or in part without payment after October 1, 2017.

16. SUBSEQUENT EVENTS

On August 13, 2003, the Authority issued \$161,825,000 of Rental Housing Revenue Bonds, 2003 Series A, B and C. The Series A and B Bonds, in the amount of \$123,700,000, were issued to finance new multi-family developments and fund Section 236 preservation agreements. The Series C Bonds were issued to refund \$38,125,000 of the Rental Housing Revenue Bonds, 1999 Series D. The 1999 Series D Bonds were called on September 3, 2003.

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MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

SUPPLEMENTAL DATA—BALANCE SHEET INFORMATION

JUNE 30, 2003

(In Thousands of Dollars)

	Section 8 Assisted Mortgage Revenue Bonds Activities	Single-Family Insured Mortgage Revenue Bonds Activities	Home Improvement Program Bonds Activities	Single-Family Mortgage Revenue Bonds Activities	Multi-Family 1988 Revenue Bonds	Rental Housing Revenue Bonds (Tax-Exempt)
ASSETS						
CURRENT ASSETS:						
Cash and cash equivalents	\$ 253	\$ 271	\$ 185	\$ 59,849	\$ 4,310	\$ 69,756
Investments, including related interest receivable	<u>13,817</u>	<u>3,292</u>	<u> </u>	<u>106,334</u>	<u>3</u>	<u>67,213</u>
Total cash and investments	14,070	3,563	185	166,183	4,313	136,969
LOANS RECEIVABLE:						
Multi-family mortgage loans:						
Construction-in-progress						116,046
Completed construction	9,624				44,666	864,122
Housing development loans						
Single-family mortgage loans		9,504	610	527,730		
Home improvement and moderate rehabilitation loans			<u>5,780</u>	<u> </u>	<u> </u>	<u> </u>
Subtotal	9,624	9,504	6,390	527,730	44,666	980,168
Add interest receivable	73	67	28	4,520	139	8,276
Less allowance for possible losses			(200)	(600)	(1,000)	(28,700)
Less mortgage discount	<u>(163)</u>	<u> </u>	<u> </u>	<u>(862)</u>	<u> </u>	<u>(1,155)</u>
Loans receivable—net	9,534	9,571	6,218	530,788	43,805	958,589
OTHER ASSETS:						
Unamortized bond financing costs	13	4		1,718	112	2,236
Real estate owned		88		5,887		404
Other		20	367	754		7
Interfund accounts	<u>(26)</u>	<u>(2,097)</u>	<u>(446)</u>	<u>10,347</u>	<u> </u>	<u>1,242</u>
Total other assets	<u>(13)</u>	<u>(1,985)</u>	<u>(79)</u>	<u>18,706</u>	<u>112</u>	<u>3,889</u>
TOTAL	<u>\$ 23,591</u>	<u>\$ 11,149</u>	<u>\$ 6,324</u>	<u>\$ 715,677</u>	<u>\$ 48,230</u>	<u>\$ 1,099,447</u>
LIABILITIES AND FUND EQUITY						
LIABILITIES:						
Bonds payable	\$ 10,671	\$ 7,087	\$ -	\$ 650,619	\$ 47,638	\$ 928,856
Accrued interest payable		92		2,683	45	5,777
Escrow funds						716
Deferred mortgage interest income						47,980
Other				<u>1,628</u>	<u>132</u>	<u>9,231</u>
Total liabilities	10,671	7,179		654,930	47,815	992,560
Fund Equity	<u>12,920</u>	<u>3,970</u>	<u>6,324</u>	<u>60,747</u>	<u>415</u>	<u>106,887</u>
TOTAL	<u>\$ 23,591</u>	<u>\$ 11,149</u>	<u>\$ 6,324</u>	<u>\$ 715,677</u>	<u>\$ 48,230</u>	<u>\$ 1,099,447</u>

(Continued)

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

SUPPLEMENTAL DATA—BALANCE SHEET INFORMATION

JUNE 30, 2003

(In Thousands of Dollars)

	1992 & 1998 Insured Rental Housing Revenue Bonds	Multi-Family 1995 Series A Revenue Bonds	General Operating Funds	Capital Reserve Capital Account	Mortgage Escrow and Reserve Funds	Other Funds	Combined
ASSETS							
Cash and cash equivalents	\$ 515	\$ 597	\$ 2,500	\$ 1	\$ 5,968	\$ 1	\$ 144,206
Investments, including related interest receivable	<u>3,033</u>	<u>4,887</u>	<u>53,469</u>	<u>41,479</u>	<u>353,969</u>	<u>37,244</u>	<u>684,740</u>
Total cash and investments	3,548	5,484	55,969	41,480	359,937	37,245	828,946
LOANS RECEIVABLE:							
Multi-family mortgage loans:							
Construction-in-progress			19,251				135,297
Completed construction	40,741	33,210	115,752			9,898	1,118,013
Housing development loans						23,445	23,445
Single-family mortgage loans			12,767				550,611
Home improvement and moderate rehabilitation loans			<u>7,722</u>				<u>13,502</u>
Subtotal	40,741	33,210	155,492			33,343	1,840,868
Add interest receivable	293	241	1,784			580	16,001
Less allowance for possible losses	(1,500)	(500)	(10,500)				(43,000)
Less mortgage discount			<u>(9,144)</u>				<u>(11,324)</u>
Loans receivable—net	39,534	32,951	137,632			33,923	1,802,545
OTHER ASSETS:							
Unamortized bond financing costs	156	91	2				4,332
Real estate owned			4,440				10,819
Other			42,786			976	44,910
Interfund accounts	<u>4</u>	<u>(3,374)</u>	<u>(19,552)</u>		<u>23,366</u>	<u>(9,464)</u>	
Total other assets	<u>160</u>	<u>(3,283)</u>	<u>27,676</u>		<u>23,366</u>	<u>(8,488)</u>	<u>60,061</u>
TOTAL	<u>\$43,242</u>	<u>\$35,152</u>	<u>\$ 221,277</u>	<u>\$41,480</u>	<u>\$383,303</u>	<u>\$ 62,680</u>	<u>\$2,691,552</u>
LIABILITIES AND FUND EQUITY							
LIABILITIES:							
Bonds payable	\$35,694	\$32,500	\$ -	\$ -	\$ -	\$ -	\$1,713,065
Accrued interest payable	208	459					9,264
Escrow funds			4,579		383,303	(8,070)	380,528
Deferred mortgage interest income							47,980
Other			<u>28,991</u>			<u>13,522</u>	<u>53,504</u>
Total liabilities	35,902	32,959	33,570		383,303	5,452	2,204,341
Fund Equity	<u>7,340</u>	<u>2,193</u>	<u>187,707</u>	<u>41,480</u>		<u>57,228</u>	<u>487,211</u>
TOTAL	<u>\$43,242</u>	<u>\$35,152</u>	<u>\$ 221,277</u>	<u>\$41,480</u>	<u>\$383,303</u>	<u>\$ 62,680</u>	<u>\$2,691,552</u>

(Concluded)

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

SUPPLEMENTAL DATA—STATEMENT OF REVENUE AND EXPENSES AND CHANGES IN FUND EQUITY INFORMATION

YEAR ENDED JUNE 30, 2003

(In Thousands of Dollars)

	Section 8 Assisted Mortgage Revenue Bonds Activities	Single- Family Insured Mortgage Revenue Bonds Activities	Home Improvement Program Bonds Activities	Single- Family Mortgage Revenue Bonds Activities	Multi-Family 1988 Revenue Bonds	Rental Housing Revenue Bonds (Tax-Exempt)
INVESTMENT INCOME:						
Loan interest income	\$ 912	\$ 497	\$ 414	\$ 40,860	\$ 2,065	\$ 88,007
Investment income—net	548	197	3	3,894	55	4,682
(Decrease) increase in fair value of investments	<u>(30)</u>	<u>329</u>	<u>—</u>	<u>639</u>	<u>—</u>	<u>1,449</u>
Subtotal	1,430	1,023	417	45,393	2,120	94,138
Less interest expense and debt financing costs	<u>991</u>	<u>444</u>	<u>—</u>	<u>38,487</u>	<u>850</u>	<u>46,693</u>
Net investment income	439	579	417	6,906	1,270	47,445
OTHER REVENUE:						
Federal assistance programs						
Section 8 Program administrative fees						
Contract administration fees						
Other income	<u>—</u>	<u>—</u>	<u>—</u>	<u>113</u>	<u>—</u>	<u>1,672</u>
Total revenue	439	579	417	7,019	1,270	49,117
OPERATING EXPENSES:						
Federal assistance programs						
Salaries and benefits						
Other general operating expenses			1			
Loan servicing and insurance costs		8	303	385		
Provision for possible losses on loans		<u>—</u>	<u>(19)</u>	<u>37</u>	<u>500</u>	<u>8,700</u>
Total expenses	<u>—</u>	<u>8</u>	<u>285</u>	<u>422</u>	<u>500</u>	<u>8,700</u>
OPERATING INCOME (LOSS) BEFORE GRANTS AND SUBSIDIES	439	571	132	6,597	770	40,417
GRANTS AND SUBSIDIES	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
NET INCOME (LOSS)	439	571	132	6,597	770	40,417
FUND EQUITY—Beginning of year	12,975	3,399	6,192	54,323	742	78,085
TRANSFERS (TO) FROM OTHER FUNDS FOR:						
Payment of operating fund expenses	(494)				(1,097)	(37,283)
Funding to provide additional cash flow and payment of bond issuance costs	<u>—</u>	<u>—</u>	<u>—</u>	<u>(173)</u>	<u>—</u>	<u>25,668</u>
FUND EQUITY—End of year	<u>\$12,920</u>	<u>\$3,970</u>	<u>\$6,324</u>	<u>\$60,747</u>	<u>\$ 415</u>	<u>\$106,887</u>

(Continued)

MICHIGAN STATE HOUSING DEVELOPMENT AUTHORITY

SUPPLEMENTAL DATA—STATEMENT OF REVENUE AND EXPENSES AND CHANGES IN FUND EQUITY INFORMATION

YEAR ENDED JUNE 30, 2003

(In Thousands of Dollars)

	1992 & 1998 Insured Rental Housing Revenue Bonds	Multi-Family 1995 Series A Revenue Bonds	General Operating Funds	Capital Reserve Capital Account	Mortgage Escrow and Reserve Funds	Other Funds	Combined
INVESTMENT INCOME:							
Loan interest income	\$3,485	\$2,956	\$ 9,709	\$ -	\$ -	\$ 1,463	\$150,368
Investment income—net	240	250	3,310	2,440		561	16,180
(Decrease) increase in fair value of investments	<u>19</u>	<u>115</u>	<u>1,676</u>	<u>1,688</u>		<u>(2,755)</u>	<u>3,130</u>
Subtotal	3,744	3,321	14,695	4,128		(731)	169,678
Less interest expense and debt financing costs	<u>2,620</u>	<u>2,868</u>	<u>180</u>				<u>93,133</u>
Net investment income	1,124	453	14,515	4,128		(731)	76,545
OTHER REVENUE:							
Federal assistance programs			221,126				221,126
Section 8 Program administrative fees			9,928				9,928
Contract administration fees			7,219				7,219
Other income			<u>5,038</u>			<u>16,099</u>	<u>22,922</u>
Total revenue	1,124	453	257,826	4,128		15,368	337,740
OPERATING EXPENSES:							
Federal assistance programs			221,126				221,126
Salaries and benefits			16,028				16,028
Other general operating expenses			17,666				17,667
Loan servicing and insurance costs			2,799				3,495
Provision for possible losses on loans			<u>934</u>				<u>10,152</u>
Total expenses			<u>258,553</u>				<u>268,468</u>
OPERATING INCOME (LOSS) BEFORE GRANTS AND SUBSIDIES	1,124	453	(727)	4,128		15,368	69,272
GRANTS AND SUBSIDIES			<u>(2,204)</u>			<u>(15,183)</u>	<u>(17,387)</u>
NET INCOME (LOSS)	1,124	453	(2,931)	4,128		185	51,885
FUND EQUITY—Beginning of year	6,940	1,740	186,536	37,351		47,043	435,326
TRANSFERS (TO) FROM OTHER FUNDS FOR:							
Payment of operating fund expenses	(724)		29,598			10,000	
Funding to provide additional cash flow and payment of bond issuance costs			<u>(25,495)</u>				
FUND EQUITY—End of year	<u>\$7,340</u>	<u>\$2,193</u>	<u>\$187,708</u>	<u>\$41,479</u>	<u>\$ -</u>	<u>\$ 57,228</u>	<u>\$487,211</u>

(Concluded)

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED UPON THE AUDIT OF THE FINANCIAL
STATEMENTS FOR THE YEARS ENDED JUNE 30, 2003 AND 2002**

To the Members of the Board of Directors of the
Michigan State Housing Development Authority and Auditor General:

We have audited the accompanying financial statements of the Michigan State Housing Development Authority (the "Authority") as of and for the years ended June 30, 2003 and 2002 and have issued our report thereon dated October 10, 2003. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information of management and others within the Authority, the Auditor General, State of Michigan, federal awarding agencies, and officials of the applicable regulatory, executive and legislative offices and is not intended to be and should not be used by anyone other than these specified parties.

October 10, 2003

